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Cases, Regulations and Statutes

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a business that consists of compensation for the performance of services by the taxpayer as an employee are not taken into account.[22]

Again, it appears that the statutory meaning of "capital assets"[23] would not require that the losses that must be added back would not be reduced by a net Section 1231 gain.[24] The provision imposing a limitation on capital losses[25] specifies that—

> "In the case of a taxpayer other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus (if such losses exceed such gains) the lower of— (1) $3,000 ($1500 in the case of a married individual filing a separate return), or (2) the excess of such losses over such gains."[26]

In applying that limitation, Schedule D allows taxpayers to reduce gains from Form 4797 by the losses from the sale of capital assets. That would be the correct result[27] only if the gains from the sale of property used in the trade or business are treated as gains from the sale of capital assets. This is an ambiguity that needs to be resolved with a technical correction.

Guidance on this issue, including the meaning of "capital asset" in this context, is expected in the near future.

FOOTNOTES

1 Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (also know as the Welfare Reform Act), Pub. L. 104-193, Sec. 909(a)(1), 110 Stat. 2105 (1996), amending I.R.C. § 32.
2 Pub. L. 104-193, Sec. 909(a), 110 Stat. 2351 (1996), amending I.R.C. § 32(i)(1), (j).
3 Pub. L. 104-193, Sec. 909(b), 110 Stat. 2352 (1996), amending I.R.C. § 32(i).
4 I.R.C. § 32(i)(2)(D).
5 I.R.C. § 32(i)(2).
6 I.R.C. § 32(i)(1).
7 I.R.C. § 1231.
8 I.R.C. § 32(i)(2)(D).
9 I.R.C. § 1222(9).
10 See I.R.C. § 1221.
11 *Id.*
12 I.R.C. § 1221(2).
13 See I.R.C. § 32(i)(2).
14 I.R.C. § 32(i)(1).
15 H.Rep. 104-651, 104th Cong., 2d Sess. 1485 (1996).
16 See IRS, Earned Income Credit, Pub. 596, 1997, at 5.
17 I.R.C. § 32(i)(2)(D).
18 See note 3 *supra*.
19 I.R.C. § 32(a)(2)(B).
20 I.R.C. §§ 32(a)(2)(B), 32(c)(5).
21 I.R.C. § 32(c)(5)(B).
22 I.R.C. § 32(c)(5).
23 I.R.C. § 1221.
24 See I.R.C. § 1211(b).
25 *Id.*
26 *Id.*
27 See I.R.C. § 1211(b).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

DISCHARGE. The debtors, husband and wife, had obtained a loan from a bank and the wife had listed a house as an asset on the financial statements given for the loan. The wife transferred the house to her father within one year of the bankruptcy filing and the bank sought denial of a discharge for the outstanding loan balance under Section 727 for fraudulent transfer of assets within one year of filing. The court held that the claim was nondischargeable because the sale of the house was made for no consideration, the wife kept the transfer secret, and the deed was suspect as to the actual date of transfer; therefore, the wife made the transfer with the intent to defraud the bank. The court held, however, that the debt was nondischargeable only as to the wife, since the husband had no ownership interest in the house and did not participate in the transfer. ***In re* Carter, 203 B.R. 697 (Bankr. W.D. Mo. 1996)**.

EXEMPTIONS

AVOIDABLE LIENS. The debtor had borrowed funds from a bank and granted the bank a security interest in currently owned and future acquired farm machinery. The bank filed a financing statement covering farm equipment "now or hereafter acquired." The debtor defaulted on the loan and the bank obtained a judgment against the debtor on the notes. The judgment awarded the bank possession of the collateral and the bank obtained possession. The debtor then filed for Chapter 7 and claimed $5,000 of the equipment as exempt. The bank scheduled an auction sale of the equipment but agreed to withhold several pieces from the sale. The debtor sought to avoid the lien as to $5,000 of the remaining equipment. The bank argued that the judgment gave the bank a possessory security interest in the equipment, making the equipment ineligible for the lien avoidance under Section 522(f). The court held that the nature of the original security interest controlled the availability of avoidance of the lien; therefore, because the original lien was nonpossessory, the lien could be avoided as to exempt tools of the trade under Section 522(f). ***In re* White, 203 B.R. 613 (Bankr. N.D. Tex. 1996)**.

EARNED INCOME TAX CREDIT. The debtors filed for Chapter 7 in April 1996 and claimed a portion of a 1995 refund as exempt earned income tax credit under Or. Rev. Stat. § 411.760 or § 23.160(1)(i). The court held that the earned income tax credit was not eligible for the exemption as public assistance of a child or spousal support payments. ***In re* Rutter, 204 B.R. 57 (Bankr. D. Or. 1997)**.

HOMESTEAD. The debtors owned 80 acres of rural land on which their residence was located. The land was fenced and had been used, in part, for pasturing cattle, an activity the debtors planned to personally continue after retirement. The residence was located on two acres with much of the rest of the property leased to third parties for agricultural use and for an oil and gas lease. The debtors claimed the entire property as a rural homestead under Okla. Const. art. , §§ 1,2 and Okla. Stat. tit. 31, §§ 1, 2. A creditor objected to the exemption in excess of two acres, arguing that the debtors did not personally make any use of the 78 acres. The court cited state court authority that the leasing of land to third parties for agricultural purposes was sufficient use of the land by the debtors to support including the 78 acres in the rural homestead. Therefore, the objection by the creditor was denied. ***In re* Kretzinger, 103 F.3d 943 (10th Cir. 1996)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

CLAIMS. The debtor filed for Chapter 11 in February 1989. On August 1, 1989, the bar date for claims, the IRS filed a claim for unpaid FUTA taxes for $550. In February 1995, the IRS filed another claim for the same FUTA taxes but in an amount of $94,600 which was reduced to $41,000 after the taxpayers provided proof of some payments. The court held that the new claim would not be allowed five years after the filing of the initial claim. The court also held that even if the new claim was seen as relating back to the original claim, an amendment of the original claim was improper under equitable considerations in that allowing the claim would prejudice other creditors' reliance on the original claim amount. **Matter of Best Refrigerated Exp., Inc., 204 B.R. 44 (Bankr. D. Neb. 1996)**.

DISCHARGE. The debtors first filed for Chapter 13 in July 1992 and the IRS filed claims for 1989, 1990 and 1991 taxes, the returns for which were filed in May 1992. The plan was confirmed but the case was dismissed before the debtors could complete the plan payments. In September 1995, the debtors filed a second Chapter 13 case and sought to have the tax claims for 1989, 1990, and 1991 declared dischargeable. The IRS argued that the three-year period of Sections 523(a)(7)(B) and 507(a)(8)(A)(ii) was tolled during the first Chapter 13 case. The court agreed with the debtors that the plain language of the statutes failed to provide any tolling of the limitation period during Chapter 13 cases. The court also held that the equities of the case did not favor the IRS because the IRS failed to take action to insure preservation of its claims in the first bankruptcy case. **Matter of Pastula, 203 B.R. 941 (Bankr. E.D. Mich. 1997)**.

DISCHARGE INJUNCTION. The debtor obtained a discharge in a Chapter 13 case which included IRS secured claims for dischargeable taxes. After the discharge, the debtor filed income tax returns claiming refunds; however, the IRS froze the refunds for offset against the unpaid portion of the bankruptcy claims. The court found that the IRS had received notice of the discharge and had refused to release the refunds even after being notified of the discharge. Therefore, the court held that the IRS willfully violated the discharge injunction against attempting to collect on discharged claims, ordered the release of the refunds and awarded the debtor costs of bringing the action. ***In re* Lovato, 203 B.R. 747 (Bankr. D. Wyo. 1996)**.

FRAUDULENT TRANSFERS. The debtor was an S corporation with one shareholder. Within one year of filing for bankruptcy, the debtor filed an election to terminate the S corporation status, although the election failed to include a Statement of Consent which was signed by the shareholder. The IRS issued an acceptance of the revocation. The bankruptcy trustee sought to avoid the revocation of the election as a fraudulent transfer under Section 544 or as ineffective because the Statement of Consent was not signed. The court held that the trustee lacked standing to challenge the revocation because the trustee had only the powers held by the debtor on the date of filing and a corporation itself had no power to challenge the revocation. However, the court also held that the revocation was a transfer and could be avoided as a fraudulent conveyance occurring within one year of the bankruptcy filing. Summary judgment was denied because of issues of fact concerning whether the revocation was fraudulent. ***In re* Trans-Lines West, Inc., 203 B.R. 653 (Bankr. E.D. Tenn. 1996)**.

SALE OF RESIDENCE. The debtor owned a residence which became part of the bankruptcy estate except for a $10,000 exemption. The residence was sold by the trustee for a substantial amount of taxable gain. The trustee sought permission to exclude the gain under the one time exclusion allowed under I.R.C. § 121 because the debtor was over the age of 55. The trustee first argued that the bankruptcy estate was similar to a decedent's estate and the exclusion was allowed under *Rev. Rul. 82-1*. The court held that the analogy was not appropriate in that a decedent's estate acts in the place of the decedent and only one income tax return is filed; whereas, under a bankruptcy case, both the estate and the debtor file separate returns. The trustee argued that the eligibility for the exclusion passed from the debtor to the estate under I.R.C. § 1398(g). The court held that there was no provision in Section 1398 for transfer of the gain exclusion right to the estate. ***In re* Barden, 97-1 U.S. Tax Cas. (CCH) ¶ 50,243 (E.D. N.Y. 1996), *aff'd*, 97-1 U.S. Tax Cas. (CCH) ¶ 50,244 (2d Cir. 1997)**.

FEDERAL AGRICULTURAL PROGRAMS

BRUCELLOSIS. The APHIS has issued interim regulations amending the brucellosis regulations concerning the interstate movement of cattle by changing the classification of Tennessee from Class A to Class Free. **62 Fed. Reg. 10192 (Mar. 6, 1997)**.

FARM LOANS. The Farm Service Agency has issued temporary regulations implementing provisions of the Federal Agriculture Improvement and Reform Act of 1996, which affect the making of direct and guaranteed farm credit program loans of the Farm Service Agency. **62 Fed. Reg. 9351 (Mar. 3, 1997)**.

The Farm Services Agency has issued proposed regulations which implement provisions of the Federal Agriculture Improvement and Reform Act of 1996 (1996 Act) that affect the Farm Loan Programs of the FSA. The provisions of this rule affect the direct and guaranteed farm ownership (FO), andoperating loan (OL) programs, and the direct emergency (EM) loan program. **62 Fed. Reg. 10117 (Mar. 5, 1997)**.

MIGRANT WORKERS. The plaintiffs were migrant agricultural workers employed by the defendants and the corporation owned by the defendants. The plaintiffs filed complaints under the Migrant and Seasonal Agricultural Worker Protection Act for operating a labor camp without a license and violating state and federal health and safety regulations. The defendants claimed that they were only employees of the corporation which owned and operated the camp. The court found that the defendants conducted the actual management and operation of the camp; therefore, the court held that the defendants were liable for any MSAWPA violations in the camp. The defendants claimed to have requested a state inspection in order to acquire a license but the defendants failed to provide any evidence of the request and no inspection was made. The court held that the failure to obtain a license was a violation of the MSAWPA. The court held that the defendants violated health and safety standards in allowing the plaintiffs to sleep in tents and under tarps and in cars. These violations also constituted violations of MSAWPA housing requirements. The defendants were held to have violated MSAWPA in failing to remove trash and litter from the housing areas. The defendants were also held to have violated MSAWPA for failing to provide common or central food handling facilities such as refrigerators. **Rodriguez v. Carlson, 943 F. Supp. 1263 (E.D. Wash. 1996)**.

PERISHABLE AGRICULTURAL COMMODITIES ACT. The debtor had purchased perishable agricultural commodities and the sellers had filed claims for payment for those commodities. The sellers had complied with 7 U.S.C. § 499e(c)(4) and placed on the sale invoices language preserving rights in the PACA trust created by the sales. A secured creditor had possession of cash assets and the commodities sellers sought recovery of those funds as part of the PACA trust res. The debtor objected, arguing that the statute limited the PACA trust res to the commodities sold to the debtor or the particular proceeds from those commodities. The court examined legislative history of the statute because no cases have been decided since enactment in 1995. The court found no evidence that the use of the invoice statements were intended to affect the definition of the PACA trust res in 7 U.S.C. § 499e(c)(2); therefore, the court held that the funds were included in the PACA trust res and subject to recovery by the commodities sellers. ***In re* Kelly Food Products, Inc., 204 B.R. 18 (Bankr. C.D. Ill. 1997)**.

The petitioner was a PACA licensed produce dealer. An employee of the petitioner formerly owned 50 percent of a produce company which was investigated for failing to promptly pay produce sellers. The employee signed a consent order admitting the alleged violations and the employee was barred from "any affiliation" with a produce company for one year. The employee was hired by the petitioner within two months for clerical work but the employee gradually became involved with the selling of produce and serving customers of the petitioner. The petitioner was notified that the employment of the employee violated PACA and the USDA eventually filed a complaint against the petitioner for violation of PACA from the hiring of the employee within one year of the consent order. The ALJ ruled that the hiring of the employee was a willful and flagrant violation of PACA and revoked the petitioner's license. The petitioner argued that revocation was too severe in that no seller went unpaid during the employment of the employee. The court upheld the revocation because the petitioner failed to take any action to remove the employee after being warned that employment violated PACA**. County Produce, Inc. v. USDA, 103 F.3d 263 (2d Cir. 1997)**.

FEDERAL ESTATE AND GIFT TAX

ADMINISTRATION EXPENSES. The decedent's estate included a 150 acre residential property which was included in a marital trust for the decedent and over which the decedent had a general power of appointment. If the decedent did not appoint the property to someone, the property passed to a residuary trust established by the decedent's predeceased spouse. The decedent did not appoint the property; however, the estate held the property until other assets were sold and until after the federal estate tax return was filed. The estate tax return included a deduction for the anticipated costs of maintaining and selling the property. The court held that the costs were not deductible because the estate gave no sufficient reason for holding the property so long and not transferring the property itself to the residuary trust where the costs would have been chargeable to the trust. **Est. of Millikin v. Comm'r, 97-1 U.S. Tax Cas. (CCH) ¶ 60,258 (6th Cir. 1997), *aff'g*, T.C. Memo. 1995-288**.

GENERATION SKIPPING TRANSFERS-*ALM* § 5.04[6].* The taxpayer had a daughter by a previous marriage but when the taxpayer's husband died soon thereafter, the daughter was adopted by the taxpayer's sister and spouse. The daughter died several years ago and was survived by two children. The taxpayer's will provided for transfers to the daughter's children, and the taxpayer made several gifts to the grandchildren. The IRS ruled that under state law, the daughter was considered a child of the taxpayer because she was adopted by a close relative. Therefore, the provisions of I.R.C. § 2612(c)(2) operated to move the grandchildren to the level of children of the taxpayer for purposes of GSTT and the testamentary and intervivos transfers were not direct skips subject to GSTT. **Ltr. Rul. 9709015, Nov. 26, 1996**.

POWER OF ATTORNEY. The decedent had executed a power of attorney appointing the decedent's daughter as the decedent's agent. The power included a written statement by the decedent that it was the decedent's intention to make gifts which would make the maximum use of the allowable tax free gift to the decedent's children, grandchildren, great-grandchildren and their spouses and that the power of attorney included the power to make such gifts. The daughter made several annual gifts equal to the maximum allowable tax-free gift statute. The IRS ruled that the gifts were not revocable because the daughter had an expressed power to make the gifts; therefore, the gifts were not included in the decedent's gross estate. **Ltr. Rul. 9708004, Oct. 31, 1996**.

REFUNDS. The U.S. Supreme Court has denied certiorari in the following case. Prior to the decedent's death, the decedent became incapacitated due to the actions of the decedent's doctor and attorney. The doctor and attorney fraudulently caused the decedent's stock to be transferred to them or their families. The doctor and attorney filed a gift tax return for the transfers and paid a substantial tax and penalties from the decedent's assets. The decedent eventually discovered the fraudulent transfers, recovered the stock and sought a refund of the taxes paid. The IRS refunded most of the taxes but refused, citing I.R.C. § 6511, to refund taxes paid more than two years before the refund claim was filed. The estate argued that the statute of limitations on the refund suit should be equitably tolled during the period the decedent was incapacitated. Although the court noted that, under *Irwin v. Department of Veterans Affairs, 498 U.S. 89 (1990)*, the U.S. Supreme Court allowed equitable tolling of statutes of limitation for claims against the United States, the court held that equitable tolling was not allowed in claims for refund of taxes and denied the estate's claim for refund. **Webb v. United States, ___ U.S. __ (1997), *denying cert*., 95-2 U.S. Tax Cas. (CCH) ¶ 60,211 (4th Cir. 1995), *aff'g*, 94-2 U.S. Tax Cas. (CCH) ¶ 60,171 (E.D. Va. 1994)**.

TRUSTS. The decedent had established a revocable intervivos trust which became irrevocable upon the decedent's death. The majority of the trust property consisted of stock in the family corporation. The trust provided that upon the decedent's death, the trust was to be split into marital and non-marital trusts which also received other assets of the estate. The nonmarital trust had the surviving spouse and three children as beneficiaries but the beneficiaries had disputes about the terms and administration of the nonmarital trust. The parties decided to split the nonmarital trust into two trusts, with two of the children as beneficiaries of one trust and the spouse and other child as beneficiaries of the other trust. The spouse's trust then purchased the noncash assets of the children's trust for fair market value. The corporation then redeemed all the stock in the children's trust at the value of corporate assets represented by the stock. The IRS ruled that the split of the trust did not cause recognition of income or gain to the beneficiaries or trusts. The IRS also ruled that the splitting of the trust and redemption of stock would not give rise to any gift tax liability to the spouse or child in the spouse's trust. **Ltr. Rul. 9709028, Nov. 27, 1996**.

FEDERAL INCOME TAXATION

BAD DEBTS. The taxpayer was president and a 33 percent shareholder of a corporation which operated a travel service business. The taxpayer made a "loan" to the corporation. Although a written note was provided, no security for the note was given and repayment was to be from corporate earnings. The court held that the "loan" was actually a capital contribution and the taxpayer could not claim a bad debt deduction for nonrepayment of the funds. The court noted that the corporation was thinly capitalized, no reserve was created to insure repayment of the funds, the corporation did not make any principal or interest payments, and the "note" was not rescheduled when the corporation rescheduled notes given to third party creditors. **Fries v. Comm'r, T.C. Memo. 1997-93**.

BUSINESS EXPENSES. The taxpayer carried on a book selling business in which the taxpayer sold books at various conventions. The taxpayer sold the books only at the conventions and had no other business location. The books were stored in the taxpayer's home. The taxpayer claimed business losses for several tax years due to advertising, travel, meals and other miscellaneous business expenses. The taxpayer provided no written substantiation of the expenses and the taxpayer claimed that the records were stolen from the taxpayer's vehicle, although the taxpayer filed no stolen property report with the police. The court refused to believe the taxpayer's explanation for lack of records and disallowed the business expenses as unsubstantiated. **Swanston v. Comm'r, T.C. Memo. 1997-103**.

DEPRECIATION-*ALM* § 4.03[4].* In 1983, the taxpayers purchased farm and ranch land which contained about 250,000 trees and schrubs which did not produce fruit or nuts and were not harvested for wood. The trees and shrubs were used primarily for a windbreak. The taxpayers assigned a $1 per plant value and claimed depreciation and investment tax credit on the trees and shrubs. The IRS denied the depreciation and investment tax credit. The court held that the trees and shrubs were not eligible for depreciation or investment tax credit because the trees and shrubs were not used for the production of fruit, nuts or wood; therefore, the trees and shrubs were part of the nondepreciable realty. **Everson v. U.S., 97-1 U.S. Tax Cas. (CCH) ¶ 50,258 (9th Cir. 1997), *aff'g*, 95-1 U.S. Tax Cas. (CCH) ¶ 50,150 (D. Mont. 1995)**.

The IRS has issued tables, revised for inflation, detailing the limitation on depreciation deductions for automobiles first placed in service during 1997:

Tax Year	Amount
1st tax year	$3,160
2d tax year	5,000
3d tax year	3,050
Each succeeding year	1,775

The IRS also issued tables providing the amounts to be included in income for automobiles first leased during 1997. The maximum allowable value of employer-provided automobiles made available to employees for personal use in 1997 for which the vehicle cents-per-mile valuation rule of Treas. Reg. § 1.61-21(e) may be applicable is $15,700. **Rev. Proc. 97-20**.

The taxpayer had claimed depreciation for business assets under Asset Class 20.4, Manufacture of Other Food and Kindred Products, as set forth in Rev. Proc. 87-56, 1987-2 C.B. 674. The depreciation was taken under a 7-year recovery period. The taxpayer claimed that the assets should have been depreciated under Asset Class 20.5, Manufacture of Food and Beverages-Special Handling Devices. The IRS ruled that the change would be a change of accounting method and would require IRS consent. The IRS also ruled that the assets would not be Class 20.4. The published ruling omits the identity of the assets. **Ltr. Rul. 9708003, Oct. 30, 1996**.

The taxpayer was self-employed in a business described by the taxpayer as research and development. The taxpayer had claimed a business loss in 1992, primarily from costs of a vehicle, which were disallowed for lack of substantiation. The court found that the vehicle was used exclusively in the business and the taxpayer did present a canceled check as evidence of the cost of the vehicle; therefore, the court allowed depreciation for the vehicle as a business expense. but disallowed a deduction for other claimed expenses. **Yecheskel v. Comm'r, T.C. Memo. 1997-89**.

HOBBY LOSSES. The taxpayers, husband and wife, were both employed as school teachers. Their residence was located on a 36-acre farm. The taxpayers intended to convert the farm to a tree farm and had converted seven acres to pine trees. The taxpayers leased 18 acres to a local farmer for $820 a year. The taxpayers claimed losses from the farm on Schedule F for three years, all of which were disallowed for lack of substantiation and lack of profit motive. The court held that the land was used for leasing and for investment purposes in that the conversion to trees was made in order to provide wealth for the taxpayer's children and future generations. The husband's employment was in a school 150 miles from the residence and the husband claimed these miles as traveled three times a week as a business expense. The taxpayers also claimed deductions for repairs, supplies and maintenance, none of which was substantiated. The court held that the deductions in excess of the rents received in each year were disallowed for lack of substantiation and lack of profit motive. The court noted that the taxpayers could not provide any evidence to support the value of appreciation of the trees. **Ward v. Comm'r, T.C. Memo. 1997-106**.

INTEREST RATE. The IRS has announced that for the period April 1, 1997 through June 30, 1997, the interest rate paid on tax overpayments is 8 percent and for underpayments is 9 percent. The interest rate for underpayments by large corporations is 11 percent. The interest rate on corporate overpayments above $10,000 is 6.5 percent. **Rev. Rul. 97-12, I.R.B 1997-__**.

IRA. The taxpayers, husband and wife, both contributed $2,000 to an IRA. The husband began employment in the middle of the tax year and the employment continued through the end of the tax year. The wife was employed at the start of the tax year but terminated employment in the middle of the tax year. While employed, both taxpayers were eligible and did participate in their employer's pension plan. The wife's interest in the plan benefits was not vested when she terminated employment. The court examined the legislative history of I.R.C. § 219(g)(5) and held that the wife was an active participant in the employer's plan even though the wife did not have a vested interest in the plan benefits and was not employed during the entire year. The same holding applied to the husband; therefore, both IRA deductions were denied. **Nicoli v. Comm'r, T.C. Memo. 1997-108**.

LIKE-KIND EXCHANGES. The taxpayer owned a one-half interest in two residential investment properties. The first property was transferred on February 5, 1990 and the second on February 14, 1990. In both cases the sale proceeds were placed in escrow with attorneys. The sale contracts both stated that the taxpayer intended to exchange the property in order to obtain like-kind gain deferral treatment. On the taxpayer's return for 1990, the taxpayer claimed to have identified replacement property on April 1, 1990, more than 45 days after either sale. The selected property was transferred on June 19, 1990 to the taxpayer. The court held that the taxpayer was not entitled to like-kind exchange treatment because the replacement property was not identified within 45 days after either transfer. **Smith v. Comm'r, T.C. Memo. 1997-109**.

LOSSES. The taxpayer had established a corporation for the purpose of acquiring television stations. The taxpayer spent considerable time and money to find investors for the proposed purchases, but the endeavor failed and the taxpayer claimed unreimbursed expenses as losses. The court held that the expenses were corporate expenses deductible only by the corporation. **Lambert v. Comm'r, 97-1 U.S. Tax Cas. (CCH) ¶ 50,225 (N.D. Ohio 1997)**.

MILEAGE DEDUCTION. The taxpayers included deductions for business use of a vehicle. The IRS disallowed much of the deduction and the taxpayers filed suit for the entire deduction. The court found that the mileage use claimed by the taxpayers was based on estimates and not on any written records; therefore, the court held that the taxpayers were allowed only the deductions allowed by the IRS. **Frias v. Comm'r, T.C. Memo. 1997-94**.

PARTNERSHIPS-*ALM* § 7.03.*

INNOCENT SPOUSE DEFENSE. The IRS issued a FPAA against a partnership in which the taxpayer's spouse was a partner. Although the TMP did not file a petition for readjustment, the other partners timely filed a petition. The taxpayer joined in the case and sought to claim the innocent spouse defense to any liability for partnership deficiencies. The court held that the innocent spouse defense was not available in a case involving issues only at the partnership level. **Life Care Communities of America, Ltd., T.C. Memo. 1997-95**.

PENSION PLANS. For plans beginning in February 1997, the weighted average is 6.88 percent with the permissible range of 6.19 to 7.36 percent (90 to 109 percent permissable range) and 6.19 to 7.57 percent (90 to 110 percent permissable range) for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 97-16, I.R.B. 1997-__, __**.

The IRS has announced that an employer is not precluded from offering, to employees (other than 5 percent owners) who attain age 70 1/2 after 1995 and have not retired, an option to defer commencement of benefit distributions under a qualified plan merely because the plan has not yet been amended to provide for the option. **Ann. 97-24, I.R.B. 1997-__, __**.

RETURNS. Under the Taxpayer Bill of Rights 2, Pub. L. No. 104-168, § 1210, 110 Stat. 1452 (1996) the "timely mailing as timely filing/paying" rule of I.R.C. § 7502(a) could be met by using designated private delivery service instead of the U.S. Postal Service. The IRS has issued procedures for designation of private delivery services as qualifying for the "timely mailing as timely filing/paying" rule of I.R.C. § 7502(a). The new procedures are effective after February 24, 1997 through the date the IRS issues new procedures. Evidently, the IRS will announce the designation of private delivery services. **Rev. Proc. 97-19, I.R.B. 1997-__, _**.

The IRS has announced that it will continue to provide yes or no answers to fact-of-filing requests from employers in the tax professional community as to whether employees and associates have filed personal income tax returns. The program has been extended through December 31, 1997. The requests are to be mailed to: Disclosure Office Stop 7000, Annex 5, P.O. Box 24551, Kansas City, MO, 64131. **Ann. 97-19**.

The IRS had prepared substitute returns for the taxpayer's 1985, 1986 and 1987 tax years. The taxpayer then filed purported copies of the returns for those years with each return claiming a refund. The taxpayer presented no evidence of the timely mailing of the returns which the taxpayer claimed were filed in late May of each following year. The taxpayer also presented the testimony of a son who claimed to have mailed his returns at the same time, although the son's returns were all received by the IRS. The taxpayer also sought excuse from timely filing because of illness. The court held that the taxpayer's and son's testimony of mailing was not credible and was insufficient to prove the mailing occurred. The court also held that the taxpayer did not have an excuse for untimely filing in that the taxpayer's illness was not severe enough to prevent the taxpayer from performing duties as a income tax return preparer. **Boone v. Comm'r, T.C. Memo. 1997-102**.

S CORPORATIONS-*ALM* § 7.03.*

ACCOUNTING METHOD. An S corporation generally must have a calendar year as its tax year; however, a corporation may not automatically change its annual accounting period to a calendar year if it attempts to elect to be an S corporation effective for the taxable year immediately following the short period required to effect the change. *Treas. Reg. § 1.442-1(c)(2)(v); Rev. Proc. 92-13, 1992-1 C.B. 665*. A corporation is precluded from an automatic change of accounting period if the accounting period had been changed within the last 10 years, six years under the Rev. Proc. 92-13. The IRS has announced that it is waiving these requirements in cases where:

(1) the corporation is otherwise eligible to change its annual accounting period;

(2) the corporation makes a timely and valid S corporation election effective for years after January 1, 1997;

(3) files completed Forms 1128 and 2553 and writes "FILED UNDER NOTICE 97-20" at the top of both forms and timely files both forms. **Notice 97-20, I.R.B. 1997-__, __**.

TRUSTS. The taxpayer established a trust funded with cash. The trust had an unrelated corporate trustee with no beneficial interest in the trust. The beneficiaries were the taxpayer's descendants and their spouses and various charitable or educational organizations. The trust gave the trustee the power to change or add charitable or educational beneficiaries. The IRS ruled that the taxpayer would be considered the owner of the trust, making the trust an eligible QSST. **Ltr. Rul. 9709001, Nov. 8, 1996**.

SALE OF RESIDENCE. The taxpayer was a partner in a partnership which purchased 19 acres including a residence. The taxpayer lived in the residence and conducted some partnership business on the property. The property was listed as a partnership asset and included as collateral on partnership loans. The partnership sold the property and the taxpayer purchased a new residence. The court held that the taxpayer could not exclude any gain from the sale of the house because the taxpayer did not have an ownership interest in the house when it was sold. **Allied Marine Systems, Inc. v. Comm'r, T.C. Memo. 1997-101**.

STATE INCOME TAX DEDUCTION. The taxpayer claimed a deduction for state and local income taxes on the taxpayer's 1990 return. In 1991, the taxpayer received a refund from the state for excess payments of state income taxes. The court held that the refund was income in 1991. **Kadunc v. Comm'r, T.C. Memo. 1997-92**.

SECURED TRANSACTIONS

SALE OF COLLATERAL. The debtors borrowed funds from a bank and granted a security interest in livestock and farm equipment. The debtors filed for bankruptcy when the loan became due and the bank obtained relief from the automatic stay to possess and sell the collateral. The collateral was sold without notice to the debtors. The debtors argued that the bank could not make a claim for the deficiency on the loan because no notice of the sale was given. The court found that the livestock were in poor condition and needed to be sold immediately; therefore, the sale of the livestock without notice was allowed and did not defeat the deficiency. However, the court held that the equipment was not in any danger of immediate loss of value; therefore, the sale of the equipment violated the notice requirements of Mo. Stat. § 400.9-504(3) and prohibited any claim for deficiency. ***In re* Carter, 203 B.R. 697 (Bankr. W.D. Mo. 1996)**.

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